

ORIGINAL

DOCKET FILE COPY ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Regulatory Treatment of LEC
Provision of Interexchange
Services Originating in the
LEC's Local Exchange Area

and

Policy and Rules Concerning
the Interstate, Interexchange
Marketplace

CC Docket No. 96-149

CC Docket No. 96-61

TO: The Commission

PETITION FOR RECONSIDERATION

The National Telephone Cooperative Association ("NTCA") and thirteen independent local exchange carriers, by their attorneys and pursuant to 47 U.S.C § 405 and 47 C.F.R. § 1.429, respectfully request reconsideration and modification of the separate entity requirement adopted in Section IV.B of the Second Report And Order In CC Docket No. 96-149 And Third Report And Order In CC Docket No. 96-61, FCC 97-142, released April 18, 1997 ("Interexchange Order"). The thirteen independent local exchange carriers ("ILECs") are Chequamegon Telephone Cooperative, Inc.; Chibardun Telephone Cooperative, Inc.; Citizens Telephone Cooperative, Inc.; Cochrane Cooperative Telephone Company; LaValle Telephone Cooperative, Inc.; Mabel Cooperative Telephone Company; Marquette-Adams Telephone Cooperative, Inc.; Nelson Telephone Cooperative; Richland-Grant Telephone Cooperative, Inc.; Spring Grove Cooperative Telephone Company; Tri-County Telephone Cooperative, Inc.; Vernon Telephone Cooperative, Inc.; and West Wisconsin Telcom Cooperative, Inc. (collectively, "the Small Telcos"). A summary of the Interexchange Order was published in the Federal Register on July 3, 1997, 62 FR 35974 (July 3, 1997).

NTCA and the Small Telcos seek reconsideration of the requirement that incumbent

No. of Copies rec'd
List ABC DE

0210

ILECs provide in-region, interstate and international interexchange services only through separate legal entities (47 C.F.R. 64.1903(b)). NTCA and the Small Telcos request that ILECs be allowed to continue furnishing in-region, interexchange services through divisions that are not separate legal entities, pursuant to long-standing industry and Commission staff interpretations of the "affiliate" requirement of the Competitive Carrier Fifth Report And Order.¹

Background

NTCA is a national association of approximately 500 local exchange carriers ("LECs") providing telecommunications services to end users and interexchange carriers throughout Rural America. It participated in the previous stages of this proceeding.

The Small Telcos are telephone cooperatives that are members of NTCA. They furnish telecommunications services to end users (most of whom are their owner-members) and interexchange carriers in rural areas, and qualify as "rural telephone companies" under Section 3(37) of the Communications Act, 47 U.S.C. § 153(37).

The Small Telcos presently resell interstate and/or international interexchange services, or plan to resell such services within the foreseeable future. None has constructed, or plans to construct, its own interstate or international network. Rather, the Small Telcos are non-facilities-based resellers of the switched interstate and international interexchange services of unrelated carriers. They lack the size, facilities, or other resources to impose unlawful rates or practices upon their interexchange customers. As a result, all of the Small Telcos are indisputably nondominant providers of interexchange services.

¹ Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities authorizations Therefor, CC Docket No. 79-252, Fifth Report And Order, 98 FCC 2d 1191 (1984) ("Competitive Carrier Fifth Report And Order").

Competitive Carrier Fifth Report And Order

At paragraph 9 of the Competitive Carrier Fifth Report And Order, *supra* at 1198, the Commission discussed and defined the interexchange "affiliates" of ILECs that it had determined to regulate as nondominant interexchange carriers. It stated:

. . . We seek to avoid imposing excessive burdens in establishing conditions for when a carrier affiliated with an exchange telephone company qualifies for forbearance, because such burdens would lessen competition and impose costs on consumers [citation omitted]. In order to provide some, albeit not complete, protection against cost-shifting and anti-competitive conduct, an exchange telephone company's affiliate qualifying for nondominant treatment must have separate books of account, and must not jointly own transmission or switching facilities with that exchange telephone company. If the affiliate uses the exchange telephone company's services, it should acquire them via the exchange telephone company's tariffs. **An affiliate qualifying for nondominant treatment is not necessarily structurally separated from an exchange telephone company in the sense ordered in the Second Computer Inquiry, 47 C.F.R. § 64.702 (e.g., fully-separated personnel and marketing are not necessary for nondominant regulation) [footnote omitted and emphasis added].**

The footnote accompanying this passage discussed the structural separation requirements imposed upon the Bell Operating Companies, GTE and other large carriers, and then stated:

. . . While we recognize that this structural separation by these large exchange telephone companies providing interstate, interexchange services impeded cost-shifting and anti-competitive conduct, it appears that a similar requirement for all smaller exchange telephone companies would be unreasonably burdensome. *See Illinois Bell, supra, slip op.* at 19 ("most of the independent companies, apart from GTE, are quite small firms that might find it very costly to establish separate subsidiaries to market customer equipment"). *Id.* at 1199 n.23.

Both ILECs and Commission staff members have interpreted the Competitive Carrier Fifth Report And Order as permitting affiliated interexchange operations of ILECs to be conducted by divisions (rather than only by separate legal entities). Several ILECs have applied openly and expressly for Section 214 authority to resell switched international interexchange services, and the Commission routinely has accepted and granted their applications under its streamlined processing procedures.² Likewise, ILECs have submitted tariffs in their own name

² *See, e.g., Public Notice* (Overseas Common Carrier Section 214 Applications Actions taken), Report No. I-8212, DA 96-1796, October 31, 1996 (Chibardun Telephone Cooperative Inc.); *Public Notice* (Overseas Common Carrier Section 214 Applications Actions taken), Report No. I-8235, DA 97-665, April 3, 1997 (The Orwell Telephone Company); *Public Notice* (Overseas Common Carrier Section 214 Applications Actions taken), Report No. I-8240, Mimeo

for international switched service resale offerings, and the Commission routinely has accepted these tariff transmittals and allowed them to become effective³.

**ILECs Should Be Allowed To Continue
Furnishing Interexchange Service Via Divisions**

The Commission should reconsider Section IV.B of its Inter-exchange Order and give ILECs the option to continue furnishing interexchange services via divisions because: (a) the Commission's Section 64.1903(a) requirements can be implemented and enforced in the same manner vis-a-vis divisions and separate legal entities; (b) the existing interexchange operations of ILEC divisions have not impaired long distance competition; and (c) the imposition of separate entity requirements upon ILEC interexchange operations will impose unnecessary costs which will adversely impact long distance competition.

Section 64.1903(a) Requirements. ILEC divisions reselling interstate and international interexchange services can readily comply with the three requirements of Section 64.1903(a) of the Rules. First, virtually all existing interexchange divisions of ILECs presently maintain separate books of account for their interexchange operations, pursuant to state commission requirements and/or conditions imposed by the Commission upon their Section 214 authorizations. Second, most existing interexchange divisions of ILECs are pure resellers, and do not own transmission or switching facilities -- either by themselves or jointly with the affiliated ILECs. Third, interexchange divisions of ILECs can purchase access and other tariffed services from their affiliated ILECs at the ILEC's tariffed rates, terms and conditions.

73873, May 1, 1997 (Glasford Telephone Co. and Chequamegon Telephone Cooperative, Inc.); and Public Notice (Overseas Common Carrier Section 214 Applications Actions taken), Report No. I-8242, DA 97-1023, May 15, 1997 (Citizens Telephone Cooperative, Inc.).

³ See, e.g., Public Notice (Tariff Transmittal Public Reference Log, Mimeo 70570, November 6, 1996 (Chibardun Telephone Cooperative, Inc. dba CTC Long Distance Tariff F.C.C. No. 1).

In sum, interexchange divisions of ILECs can comply with the three Section 64.1903(a) requirements as readily and thoroughly as separate legal entities. Likewise, the Commission can monitor and enforce compliance with these requirements as effectively and efficiently by inspecting the books and records of divisions as it can by inspecting the books and records of separate legal entities.

Existing Divisions. As noted above, the Commission has permitted a number of ILECs openly to furnish interstate and/or international interexchange service via divisions. New Section 64.1903(c) of the Rules recognizes the existence of these arrangements, and gives such ILECs until April 18, 1998 to come into compliance with the Interexchange Order's new "separate entity" requirements.

The record of existing ILEC interexchange operations shows that they have created or enhanced interexchange competition in Rural America -- whether they have provided service via divisions or via separate legal entities. As the Commission is aware, the major problem limiting interexchange competition in Rural America is the reluctance of potential toll competitors to serve isolated and sparsely populated exchanges. See Iowa Network Access Division, 64 RR 2d 1167, 1170 (Comm. Car. Bur. 1988) (AT&T competitors had focused on larger Iowa exchanges; only 17.5 percent of Iowa exchanges were receiving originating interLATA toll service from two or more carriers at the time of the proceeding). In Iowa, Minnesota, South Dakota and Kansas, groups of ILECs have responded to the lack of interest by potential interexchange competitors in the extension of their networks to rural areas by constructing centralized equal access systems to aggregate the traffic of dozens of rural exchanges at an attractive central point. In the many states where centralized equal access systems have not been constructed, the primary (and often the only practicable) source of competing interexchange service in rural areas is the local ILEC.

The Small Telcos and other ILECs are small businesses which lack the resources to

construct and operate their own interstate or international networks. They have no choice at present or during the foreseeable future but to resell the services of facilities-based interexchange carriers. They also lack the resources to market their resold services beyond their exchanges and adjacent areas. Even though they have some local name recognition, they are unable to advertise their services in the print and broadcast media in the manner necessary to develop brand names and loyalty like AT&T, MCI and Sprint.

Put another way, local ILECs are the only entities willing to offer competitive toll service in many rural areas, and one of a small number of such entities in others. However, given their limited financial, network and marketing resources, they are forced to offer this competition as pure resellers within generally small and sparsely populated areas in and around their local exchanges. The small scope of their operations and their dependence upon facilities-based carriers renders it most unlikely that they can develop sufficient market power to control interexchange service prices, or to engage in anticompetitive conduct capable of driving the underlying facilities-based carriers from their markets or discouraging other potential competitors from entering. Rather, the primary function of most interexchange affiliates of local ILECs is to aggregate some local toll traffic to obtain volume discounts, and to give local customers an opportunity to save 2-to-5 percent on their residential toll rates.

NTCA and the Small Telcos know of no instance where the provision of interstate and/or international interexchange services by existing divisions of ILECs has resulted in cost-shifting, or otherwise adversely impacted interexchange competition or rates. Even if the Commission were to discover such practices in isolated instances, it has sufficient authority under Section 208 of the Act to put an end to them, and to impose appropriate sanctions and relief. However, in light of the economics of rural interexchange competition and the absence of any record of anticompetitive conduct by existing interexchange divisions of ILECs, there is no apparent need or benefit at this time for a blanket prohibition against the conduct by all ILECs of interexchange operations via divisions.

Adverse Impact of Separate Entity Requirement. The Interexchange Order's "separate legal entity" requirement will impose additional and unwarranted administrative, personnel and tax costs upon ILECs which have exercised, or plan to exercise, their option to conduct interexchange operations via divisions.

These additional costs constitute a particularly serious hardship at this time, because various changes in the tele-communications industry threaten the relatively small margins realized by interexchange service resellers affiliated with small ILECs. In addition to increasing RBOC/GTE and Internet competition in the long distance market, these small resellers are faced with the prospect of substantial Universal Service Fund contributions based upon their end-user telecommunications revenues (rather than their profits). The resulting revenue losses and cost/contribution increases threaten the margins and viability of all small resellers, including those affiliated with ILECs.

It is ironic that federal and state provisions regarding local competition permit large, facilities-based toll carriers to offer one-stop local exchange, interexchange and enhanced services via a single entity, whereas the Interexchange Order allows rural telephone companies with less than one percent of the assets or revenues of large toll carriers to offer local and interexchange services only through separate entities.

The Interexchange Order's requirement of separate legal entities entails legal, accounting and other administrative costs at the time of the organization of such entities, as well as recurring costs to maintain them. These costs are not necessary to achieve compliance with the Commission's three Section 64.1903(a) requirements, and constitute, per se, an undue hardship for small resellers.

In addition, the small size of rural telephone companies -- averaging less than 25 employees in the case of the Small Telcos -- exacerbates the costs and dislocations inherent in separate entity requirements. For example, the sharing of small staffs of employees between

separate entities creates accounting costs and complications regarding compensation, benefits, pension plans, and payroll taxes. It also makes it more difficult to attract and retain employees with concerns regarding income potential and security arising from the fact that they will be required to divide their time between (and be supervised, reviewed, promoted and compensated by) two or more separate entities.

The Interexchange Order will also have the apparently unintended effect of limiting the tax status options of telephone cooperatives under the Internal Revenue Code. These entities may qualify for tax exempt status under the Internal Revenue Code if, inter alia, no less than 85 percent of their revenues consist of amounts collected from members for the sole purpose of meeting losses and expenses. I.R.C. § 501(c)(12)(A). A recent Internal Revenue Service (IRS) Technical Advice Memorandum held that the gross income from the subsidiary of a telephone cooperative was to be counted as non-member income in applying the 85 percent test. Priv. Ltr. Rul. 97-22-006 (Feb. 7, 1997). Thus, the Commission's requirement that all ILECs provide interexchange service through separate subsidiaries will, as a practical matter, eliminate the tax exemption option for telephone cooperatives reselling interexchange services, thereby increasing their cost of providing both local and toll services.

Conclusion

Small ILECs have resold interexchange services via divisions since the Commission's 1984 Competitive Carrier Fifth Report And Order without any adverse impact upon toll competition or the Commission's regulatory requirements. In fact, these small ILEC resale operations have been a primary (and often, the only) source of toll competition in many rural areas. The Commission should reconsider the separate entity requirement adopted in Section IV.B of its Interexchange Order, and permit ILECs to continue furnishing in-region, interexchange services through divisions that are not separate legal entities.

Respectfully submitted,

NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

By David Cosson (GDD)
David Cosson
Vice President - Legal & Industry

2626 Pennsylvania Avenue, N.W.
Washington, D.C. 20037
(202) 298-2300

**CHEQUAMEGON TELEPHONE COOPERATIVE, INC.
CHIBARDUN TELEPHONE COOPERATIVE, INC.
CITIZENS TELEPHONE COOPERATIVE, INC.
COCHRANE COOPERATIVE TELEPHONE COMPANY
LAVALLE TELEPHONE COOPERATIVE, INC.
MABEL COOPERATIVE TELEPHONE COMPANY
MARQUETTE-ADAMS TELEPHONE COOPERATIVE, INC.
NELSON TELEPHONE COOPERATIVE
RICHLAND-GRANT TELEPHONE COOPERATIVE, INC.
SPRING GROVE COOPERATIVE TELEPHONE COMPANY
TRI-COUNTY TELEPHONE COOPERATIVE, INC.
VERNON TELEPHONE COOPERATIVE, INC.
WEST WISCONSIN TELCOM COOPERATIVE, INC.**

By Gerard J. Duffy
Gerard J. Duffy

Blooston, Mordkofsky, Jackson & Dickens
2120 L Street, N.W., Suite 300
Washington, D.C. 20037
(202) 659-0830

Dated: August 4, 1997